Delivering innovative communications solutions and exceptional value to our customers in Manitoba and beyond.

WELCOME TO THE

FUTURE

MANITOBA TELECOM SERVICES INC.

ANNUAL REPORT 1997

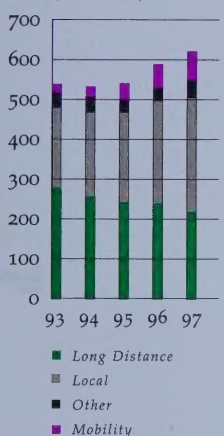
Our customers are our future. With business customers like **LARRY McINTOSH**, *CEO of Manitoba's Peak of the Market, valued Sympatico™ Internet service customers like* **MARY STEELE** *and Personal Communications Services customers like* **TOM FULLAN**, *our future is bright.*

FINANCIAL HIGHLIGHTS

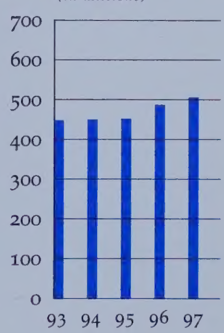
	Years Ended December 31		
	1997	1996	%
SELECTED OPERATING ITEMS *(thousands)*			
Operating revenues	$ 620,153	$ 589,325	5.2
EBITDA (before extraordinary item)	305,570	296,044	3.2
Income before extraordinary item	84,664	32,400	161.3
PER SHARE INFORMATION			
Earnings per share before extraordinary item	$ 1.21	$ 1.08*	12.0
Dividends per share	0.68	—	—

*pro forma

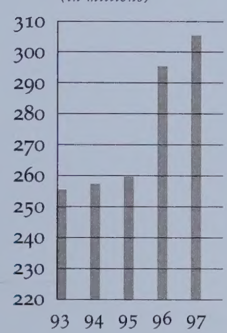
OPERATING REVENUES
(in millions)



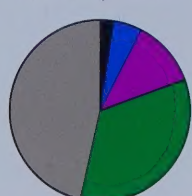
OPERATING EXPENSES
(in millions)



EARNINGS BEFORE INTEREST, INCOME TAXES, DEPRECIATION, AND AMORTIZATION
(in millions)



OPERATING REVENUES
(millions of dollars)



Local	$ 290.9	46.9%
Long Distance	$ 211.9	34.2%
Mobility	$ 72.0	11.6%
Directory and Online Multimedia	$ 31.9	5.1%
Other	$ 13.5	2.2%

THOMAS E. STEFANSON *Chairman and* **WILLIAM C. FRASER** *President & CEO*

TO THE SHAREHOLDERS

At the outset of 1997, MTS stood at the threshold of a new era in the Company's 90-year history. By year's end, MTS had completed its first full year as a privatized, publicly-traded corporation, achieving high performance objectives and laying the foundation for further growth and progress.

DELIVERING SHAREHOLDER VALUE

First and foremost, 1997 was a year in which MTS added substantially to shareholder value through solid financial performance.

Operating revenues in 1997 increased 5.2% over the previous year to a record $620.2 million, producing income before the extraordinary item of $84.7 million or $1.21 per share, an 11.8% gain over 1996, when compared on a pro forma basis. These gains primarily reflect continued strong growth in local, wireless, and Internet services, and aggressive action taken to retain MTS's share of the long distance market.

As a result of MTS's privatization and its initial public offering, completed in January 1997, the Company entered the year with a strong balance sheet and the financial flexibility to deliver on its growth strategies. This financial strength was augmented through the year, as MTS ended 1997 with total equity of $662.8 million and a debt ratio of 36.8%, one of the lowest among the Stentor companies (Canada's alliance of full-service telecommunications providers). Cash flow also increased significantly, as the Company produced cash from operations of $205 million or $2.93 per share, a 9.9% increase over 1996.

Shareholders benefitted from MTS's strong financial performance by receiving quarterly dividends of $0.17 per share, or $0.68 per share for the year.

A further milestone was reached in the third quarter when MTS was added to both the TSE 300 Composite Index and the TSE 200 Index. MTS's inclusion in these prestigious indices will broaden the Company's investor audience as it continues to grow.

BUILDING ON MTS'S STRENGTHS

In addition to its solid financial position, MTS built on the significant strengths developed since its founding in 1908: MTS maintains excellent brand recognition with very high levels of customer loyalty and goodwill; MTS holds a leadership position in each of its chosen markets; MTS has one of the most advanced digital networks in North America, providing province-wide coverage to 1.1 million Manitobans; and MTS continues to build on its full-service capabilities, remaining the only provider of a complete range of telecommunications products and services in the province.

Throughout its corporate life, MTS has been a vital part of the Manitoba landscape. Employing more than 3,000 Manitobans, MTS continues to provide quality, knowledge-based opportunities for people in communities throughout the province. MTS has invested hundreds of millions of dollars in the provincial economy, and further enriches both urban and rural communities through its active support of sports, cultural, and local events.

A STRATEGY FOR THE FUTURE

The Company's focus on the future recognizes the reality that traditional telephone services – local, access, data, and long distance segments – will comprise a shrinking percentage of the total telecommunications market and will be characterized by commodity pricing and lower margins.

While MTS remains committed to providing Manitobans with the best service in these traditional segments, the Company's strategy to grow the business is to pursue opportunities in the newer communications services – including broadband, wireless and Internet. In addition, MTS remains dedicated to being cost competitive in all areas of the Company.

PRIORITIES FOR GROWTH

To continue to enhance shareholder value, MTS will focus on three corporate priorities.

The first priority is growth. MTS will expand and diversify into new communications services and market segments that lever and complement its core strengths. Strategic alliances and joint ventures will be essential for expanding into new areas both within Manitoba and for investing prudently in new markets.

The second priority is cost. MTS will act decisively to reduce operations expenses in the high fixed-cost traditional service areas. Minimum target rates have been established for annual improvements in these businesses. Rest assured that these necessary efficiencies will be achieved while maintaining the high level of service excellence that Manitobans have come to expect from their telecommunications company.

The third priority is a realignment of resources required to spur increased growth and cost reduction. Internal structures within MTS are being re-examined to reduce overheads, improve customer responsiveness, and pursue opportunities inside and beyond Manitoba.

A RESTRUCTURED ORGANIZATION

MTS initiated a number of organizational changes in the latter part of the year. The local and long distance units were integrated into one operating unit – MTS NetCom – to align their processes for increased efficiency, to enhance customer service opportunities, and to increase competitive responsiveness. A new international legal entity was created to pursue opportunities outside Manitoba. Project Apex was begun in September, a 13-month program designed to more efficiently provide financial information through the integration of financial and administrative systems across the entire company.

And finally, more flexibility was emphasized in MTS Mobility and MTS Advanced to ensure the Company capitalizes on the explosive growth envisioned for both of these segments.

A NEW REGULATORY ENVIRONMENT

In 1997, MTS successfully completed its transition to a publicly-traded company operating in a highly-competitive environment. Looking ahead, the move to price-cap regulation, regulatory forbearance in long distance, and the advent of local competition in January 1998 will present challenges and opportunities for MTS. The Company has successfully been competing in its other business segments for a number of years, and we are confident MTS and its employees will again adapt and embrace change.

A SOLID PLATFORM FOR GROWTH

In 1997, MTS began life as a public company as the service provider of choice for Manitobans, built on a heritage of unequaled service and technological innovation. We understand our customers and their needs, and have demonstrated our ability to successfully meet those needs by delivering the right products and services at affordable prices. This leading market presence constitutes an enormous competitive advantage and a solid platform for growth as MTS flourishes within the rapidly expanding North American telecommunications business.

The Company's Board of Directors has made a significant contribution to the Company's first year as a publicly-traded entity. Board members have brought a wealth of knowledge from diverse backgrounds, and we look forward to their continued active participation in helping to formulate MTS's future strategy.

MTS's success in the past, and in the future, depends on the dedication, skill, and initiative of its employees. MTS is committed to fostering a corporate culture that responds quickly and effectively to changing market dynamics, attracting and retaining the best people, who are empowered and accountable for delivering results.

We would like to conclude by thanking all our employees for their contributions to a most successful first year as a publicly-traded company. They have clearly demonstrated their ability, and their willingness, to embrace the opportunities presented by a rapidly changing business environment. In particular, we want to thank them for their extraordinary efforts during the Flood of '97. It is their effort and their initiative that will continue to build MTS as one of North America's leading telecommunications firms, delivering superb service to our customers and enhanced value to our shareholders.

The balance of this year's annual report highlights the significant financial and operational achievements of 1997. We welcome a future where our markets become more global; where we continue to build on our enterprising spirit, delivering valuable, innovative, and reliable services to our customers; and where growth is our overriding ambition.

THOMAS E. STEFANSON
Chairman

WILLIAM C. FRASER
President & CEO

January 29, 1998

CHERYL BARKER *Vice President Finance & CFO,* **BRUCE MacCORMACK** *President & COO MTS Advanced Inc.,* **JAMES FITZGERALD** *President & COO MTS Mobility Inc.,* **WILLIAM C. FRASER** *President & CEO Manitoba Telecom Services Inc.,* **BILL BAINES** *President & COO MTS NetCom Inc.,* **ROGER BALLANCE** *Executive Vice President Strategic Planning*

MANITOBA TELECOM SERVICES

Manitoba Telecom Services Inc. is a publicly-held company whose shares are traded on the Winnipeg, Toronto, and Montreal Stock Exchanges (stock symbol: MBT). The company is comprised of a corporate office and three subsidiaries, whose assets, taken together, total more than $1.2 billion. The corporate office coordinates business strategy, major investment decisions, strategic alliances, and network technology planning, that cross the boundaries of the three operating units. The corporate office also carries out MTS's financial, investor relations, industrial relations, regulatory affairs, legal, internal audit, public relations, and community relations activities.

MTS NETCOM

MTS NetCom Inc. is the primary telecommunications provider in the MTS group of companies, offering Manitobans a full range of local, long distance, data, and enhanced telecommunications services, employing its integrated, fully digital switched province-wide network. MTS NetCom is also responsible for the company's call centre initiatives, wholesale market offerings, and sales channel management.

MTS MOBILITY

MTS Mobility Inc. is the preferred provider of wireless communications services in Manitoba, with a cellular network covering 95% of Manitoba. MTS Mobility's three core businesses, cellular, paging, and group communications will be augmented in early 1998 by Personal Communications Services (PCS).

MTS ADVANCED

MTS Advanced Inc. is the online multimedia and directory publishing subsidiary of MTS. The Yellow Pages™ advertising portfolio includes the printed directory, the Talking Yellow Pages™ and the Manitoba Internet Yellow Pages.™ MTS Advanced also offers ngage Electronic Commerce™ to businesses selling products, services, and information on the Internet. MTS Advanced is responsible for Sympatico™ Internet service, and ViewCall Canada Inc., a subsidiary of MTS Advanced, that provides Canada's first personalized Internet television service called Beyond TV™ – net connected television.™

MANITOBA TELECOM SERVICES INC.
- MTS NETCOM INC.
- MTS MOBILITY INC.
- MTS ADVANCED INC.

Yellow Pages and Talking Yellow Pages are trade-marks of Tele-Direct (Publications) Inc. MTS Advanced Inc. is a licensed user. Beyond TV– net connected television is a design trade-mark of ViewCall Canada Inc. ngage Electronic Commerce is a design trade-mark of MTS Advanced Inc. Sympatico is a registered trade-mark of MediaLinx Interactive Inc. MTS Advanced Inc. is a licensed user.

THE FUTURE IS GROWING

The growth of telecommunications has been substantial, especially in wireless and multimedia services. MTS will capture its share of these expanding markets profitably, building on our reputation for providing cutting edge technology and top-notch service. An example of that commitment is the next generation of wireless communications: Personal Communications Services (PCS). Digital PCS provides greater clarity, enhanced security, and up to five times the talk-time of a conventional cellular phone.

Making technology work is what makes MTS grow: Ric Coy, Senior Product Manager, MTS NetCom, Pat Palanuk, Senior Technology Planner, MTS Mobility, and Wing Kwong, Technology Planner, MTS Advanced, help keep MTS on the cutting edge

ONLINE AND WIRELESS GROWTH

The growth of telecommunications worldwide has been substantial. In Canada alone, the market for telecom-related services is expected to grow to $30 billion by the year 2001, up from $22 billion today. The fastest growth is expected in wireless and online multimedia services, areas where we are particularly strong.

With about 70% market share in Manitoba, MTS has over 100,000 cellular customers, and expects annual growth in the 15 to 20% range for the foreseeable future. In fact, only about 12% of the addressable market has been captured in the province. Industry analysts suggest a 35 to 40% penetration rate in Canada by 2005.

PERSONAL COMMUNICATIONS SERVICES

The really exciting news at MTS Mobility, however, is Personal Communications Services, or PCS. Digital PCS provides improved clarity, enhanced security, and four to five times the talk-time of a conventional cellular phone. In June, we signed an agreement with Nortel (Northern Telecom) to supply infrastructure for a new all-digital, wireless network. This advanced network will allow us to incorporate the latest cellular, paging, voice mail, and Internet features in our PCS offering.

We have chosen a new generation of cellular technology called CDMA (Code Division Multiple Access) as the basis for our digital network because it provides greater security and capacity, allowing more customers on the network and greatly reducing the number of dropped calls and network busy signals. CDMA is the standard adopted by the majority of North American companies offering PCS. PCS is being rolled out early in 1998, and in the initial stages, it will offer customers in Winnipeg advanced features such as Call Display and Message Waiting Indicator. The digital wireless network will also be extended to rural Manitoba, providing new growth opportunities.

LEADERSHIP ONLINE

MTS is also strengthening its leadership in the online world. MTS Advanced is the largest commercial Internet provider in the province. At December 31, 1997, there were more than 20,000 *Sympatico* customers. We have also developed multimedia applications for the Internet that flow from the *Yellow Pages* tradition of bringing buyers and sellers together – now through multimedia and online commerce tools that give our customers a competitive edge.

VIRTUAL CALL CENTRES

There was good news for companies looking for innovative ways to use technology to improve customer service in 1997. In September, in conjunction with IBM Canada, we announced the development of Network Based Call Centre technology, a new service allowing small and large businesses alike to access state-of-the-art call centre technology and expertise without incurring large capital expenses. The partnership combines our network expertise with IBM Canada's strength in Computer Telephony Integration (CTI) to help businesses enhance customer service and maintain a competitive advantage.

With Network Based Call Centre, business customers can employ CTI functions such as personalized answering, skills-based routing, management information service, and Interactive Voice Response (IVR), without having to purchase the associated equipment – all the requisite technology resides on our network. Network Based Call Centre represents a new source of revenue for MTS – and a new opportunity to draw revenues from beyond Manitoba's borders.

THE FUTURE IS

GLOBAL

Our vision, network, and skills are world-class; so are our aspirations. We will create a bright future for our customers and shareholders by pursuing opportunities for growth at home and beyond. This we will do prudently, complementing the revenues and loyalty we have worked so diligently to cultivate in Manitoba. The fruits of that pursuit include access to the online world from the comfort of your living room. In November, MTS Advanced (through its subsidiary ViewCall Canada Inc.) launched Beyond TV–net connected television, Canada's first personalized Internet television service.

BEYOND BORDERS

Burgeoning demand for telecommunications in Canada and around the globe has created, quite literally, a world of opportunity for MTS. Capitalizing on those opportunities is an increasingly important part of our growth strategy – one that challenges us to expand our horizons while maintaining our pre-eminence in a Manitoba marketplace that remains core to our continued success. In 1997, the Company struck a profitable balance; surpassing expectations within our provincial borders while aggressively pursuing opportunities beyond them.

In January, the Company signed an agreement with US-based Pacific Bell that saw a number of MTS employees deployed to California to help with weather-related repairs and other work. The initial contract was extended on the strength of the work completed. In November, a second contract was signed, sending more MTS employees south to help Pacific Bell cope with peak demand and tremendous growth in the San Francisco Bay area.

The contracts with Pacific Bell reflect MTS's increasingly successful efforts to export telecom-related services and expertise outside of Manitoba. In addition to contracts in California with Pacific Bell, we have secured contracts throughout North America and the UK. In 1997, revenue generated through these endeavors was approximately $11 million, more than a tenfold increase over the $1 million generated in 1996.

Moving beyond traditional borders. Rick Babington, General Manager Business Opportunities & Process Re-engineering, MTS NetCom, and Tim Nickerson, Managing Director, ViewCall Canada Inc., are key figures in MTS's effort to expand its markets

ELECTRONIC COMMERCE

MTS has also moved beyond provincial boundaries with a number of new services. In November, we launched *ngage Electronic Commerce* (pronounced "engage"), the first complete Internet commerce solution for business. The service centrally manages online transactions, fulfillment, and administrative processes for business in a fast, user-friendly, and secure environment.

Clients of the service need no additional hardware or software, and *ngage Electronic Commerce* provides the training and technical support. *ngage Electronic Commerce* offers any business the ability to capitalize on the rapidly growing world market for Internet commerce – and the opportunity to make the most of any commercial online presence, from the *Internet Yellow Pages* to a fully commerce-enabled web site. In 1996, $1 billion in goods and services were purchased through the Internet worldwide; the market is expected to grow to more than $73 billion by 2000.

BEYONDTV

In November, ViewCall Canada Inc. (a subsidiary of MTS Advanced) launched *BeyondTV – net connected television*, Canada's first personalized Internet television service. *BeyondTV* brings the Internet to the television through a special "set-top box" that keeps viewers in touch with the world through e-mail and access to the World Wide Web. From the comfort of their living room couch, viewers can personalize information, entertainment, and other Internet services with the click of a remote control.

The first service of its kind in Canada, *BeyondTV* is the perfect online solution for customers who prefer the comfort of surfing the Net through their television set. And because it offers access to the online world through the television, *BeyondTV* transforms the act of going online from a solo activity to one the whole family can enjoy together.

These forays into markets beyond our traditional scope are just the beginning. In the coming years, we will continue to capitalize on opportunities for growth to generate new sources of revenue and increase shareholder value. This we will do prudently, complementing the revenues and loyalty we have worked so diligently to cultivate in Manitoba.

THE FUTURE IS

ENTERPRISING

In the increasingly competitive world of telecommunications, the future belongs to those who are resourceful, imaginative, and energetic. MTS is all of these things and in 1997, introduced a host of new services while expanding the penetration and appeal of those that already existed. Visual Call Waiting, available with the Vista 350 phone, is one of the latest additions to our profitable suite of Call Management Services. Visual Call Waiting enables users already on the phone to see who is calling, and gives them six different ways to handle a call that comes in while they are on the line.

MTS employees like Dennis Jones, General Manager Business Development, MTS Mobility, and Cathy Miller, General Manager Product Marketing, MTS NetCom, strive to bring innovative new products to market, and to continually improve those already there.

FLEETNET 800

In the increasingly competitive world of telecommunications, the future belongs to those who are resourceful, imaginative, and energetic. MTS is all of these things, and in 1997, introduced a host of new services while expanding the penetration and appeal of those that already existed.

We again proved our ability to successfully market existing services in December, as we worked to finalize a major *FleetNet 800* contract with the RCMP. Under the terms of the ten-year, $60 million contract, MTS Mobility will provide the RCMP with Manitoba-wide *FleetNet 800* service. *FleetNet 800* is an enhanced, trunked radio dispatch network with more features and flexibility than existing radio networks. *FleetNet 800* customers can talk one-on-one, within a group, or with all units simultaneously. During the Flood of the Century, *FleetNet 800* proved itself indispensable as the primary communication tool for key flood-related agencies including National Defence, the RCMP, the provincial government, and our own emergency personnel.

MTS will invest in network infrastructure over the next two years to build a province-wide *FleetNet 800* network, to meet growing demand.

SPEED AND CONVENIENCE

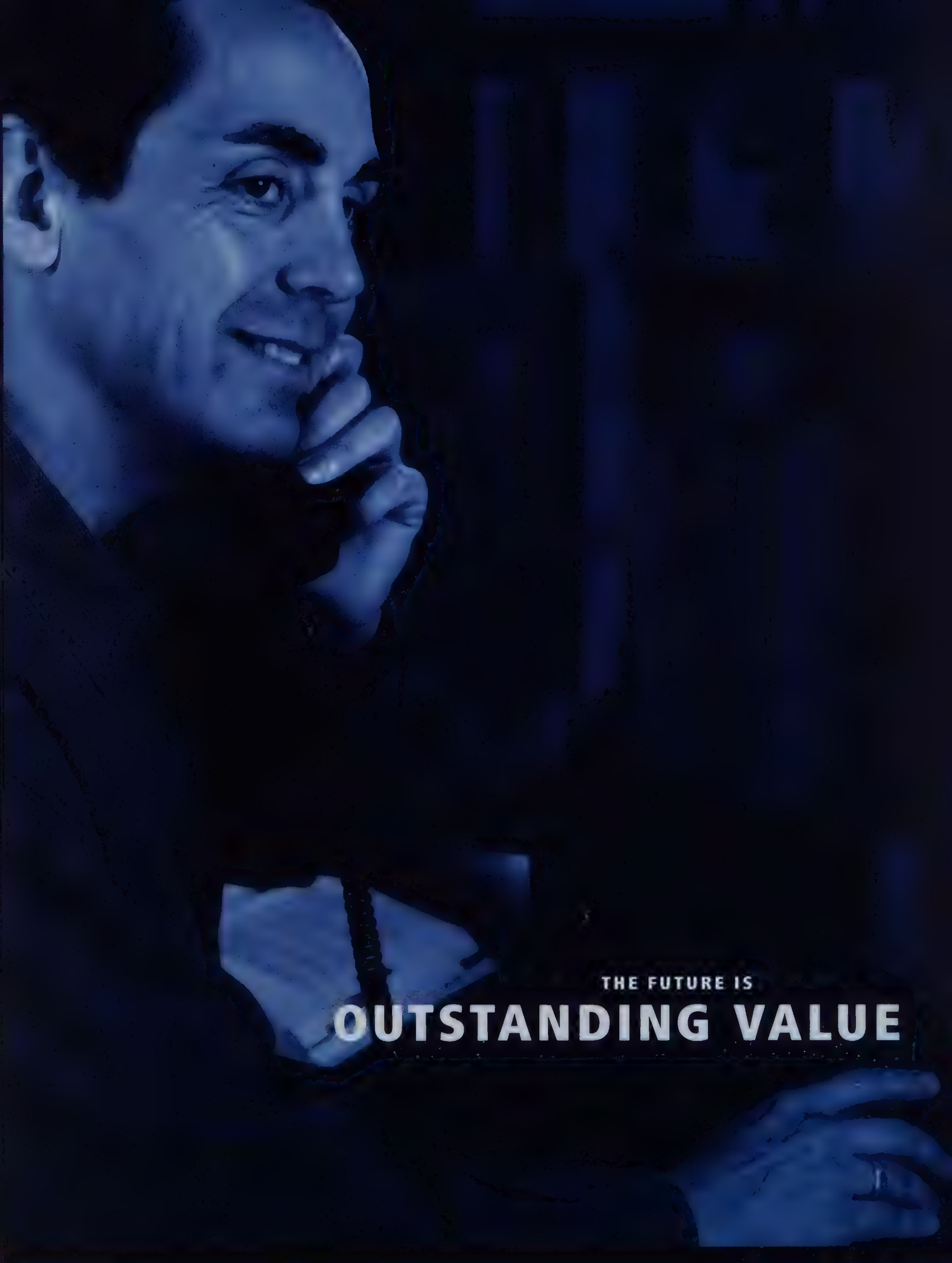
In June, we completed the successful market trial of ADSL (Asymmetric Digital Subscriber Line) service, a cutting-edge technology that allows ordinary telephone lines to carry data at rates that far exceed existing 28.8 modem speeds. An additional benefit of the ADSL service is that customers can use their telephone at the same time they are using their MTS ADSL Line to access the Internet.

MTS also launched Visual Call Waiting and Voice Mail Messaging, the latest additions to our profitable suite of network-based Call Management Services. Visual Call Waiting enables users already on the phone to see who is calling, and gives them six different ways to handle a call that comes in when they are on the line (like putting it on hold or sending it to Call Answer). Voice Mail Messaging is a new enhancement to our popular Call Answer service that makes it easier for customers to forward messages to friends. It also allows them to reply to messages at the touch of a button, without making the other person's telephone ring. This feature makes Call Answer an even more efficient alternative to the manual answering machine.

EMPLOYEE INITIATIVE

Our spirit of enterprise manifests itself not only in the products and services we offer our customers, but also in the energy our employees contribute to the company's success. Their enthusiasm is reflected in the continued popularity of Tel-1-More, a voluntary sales incentive program for all MTS employees. Since its inception in 1993, Tel-1-More has generated 187,000 sales leads and over $20 million in revenues. The already-successful program underwent a major revamping in 1997, one designed to make it an even more powerful sales channel.

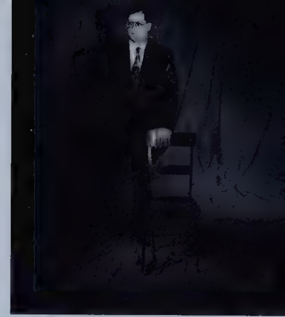
FleetNet 800 is a trade-mark of Sasktel Mobility, a division of Saskatchewan Telecommunications Holding Corporation. MTS Mobility is a licensed user.



THE FUTURE IS

OUTSTANDING VALUE

In the face of competitive prices, loyalty and goodwill only go so far; we must reward our customers with attractive prices and good value. Over the past year, we responded aggressively to this challenge, offering consumers outstanding value for their telecommunications dollar. With MTS long distance rates lower and more competitive than ever, MTS customers have good reason to smile.



Like all MTS employees, Rick McMillin, Marketing Manager Long Distance, MTS NetCom, is working hard to ensure that MTS continues to offer its customers the best overall value for their telecommunications dollar.

ATTRACTIVE PRICING – OUTSTANDING VALUE

Despite the efforts of a growing number of competitors in 1997, MTS continued as the telecommunications supplier of choice for the majority of Manitobans, thanks in part to a long history of goodwill, loyalty, and trust we have fostered over our 90-year history. Yet loyalty and goodwill only go so far in the face of competitive prices. It is imperative that we reward our customers with attractive prices and outstanding value. Over the past year, we responded aggressively to this challenge, offering consumers outstanding value for their telecommunications dollar.

FIRST RATE SAVINGS

In 1997, MTS launched the First Rate™ long distance savings plan for residential customers. The plan offers extremely competitive flat rates for long distance calls made between 6 pm and 8 am Monday to Friday, and all weekend. Since Manitobans place most of their long distance calls during the evenings and weekends, the *First Rate* plan is ideally positioned to help customers maximize their long distance savings.

The Company also announced MTS Business Cents,™ our most aggressive – and simplest – savings plan for small business customers. The *Business Cents* savings plan represents the best deal yet for our small business customers, allowing them to stretch their communications dollar farther than ever before.

ONLINE SOLUTIONS

Our attention to good value wasn't restricted to voice communications alone. In online services, we unveiled Business Internet,™ promising Internet solutions for our business customers who demanded greater bandwidth. On the leading edge of commercial Internet services in Canada, *Business Internet* is a competitively-priced, full-service solution offering one-stop shopping for Internet access and related technologies and services, as well as discounted contract rates. The service also enables customers to monitor their own bandwidth usage for improved corporate expense control.

In reworking price options based on bandwidth usage, *Business Internet* ensures that Manitoba companies only pay for the levels of Internet service they need and use – while retaining the premium performance of our network.

First Rate and Business Cents are trade-marks of MTS NetCom Inc. Business Internet is a design trade-mark of MTS Advanced Inc.

THE FUTURE IS RELIABILITY

Even the best rates are meaningless in the absence of reliable service. While fighting the worst flood this century, Manitobans found they could rely on two things: a seemingly never-ending supply of courage and determination, and an MTS network they could count on. The tireless efforts of MTS employees like Line Cable Technician Ben St. Hilaire played a key role in ensuring our network was there in good times and during the flood, when our customers needed it most.

FLOOD VICTORY

Recognizing that even the best rates are meaningless in the absence of reliable service, we went to extraordinary lengths in 1997 to ensure customers could continue to rely on our network during even the worst possible circumstances.

In fact, any discussion of our success in our first year as a private company would be incomplete without relating one of the telecommunications industry's biggest stories in 1997: our victory over the Red River during Manitoba's worst flood in this century.

In the spring, the Red River spilled its banks and converted much of southern Manitoba into what became known as the Red Sea. During its assault, it forced thousands of Manitobans to abandon their homes and livelihoods in search of higher ground.

AWARD-WINNING SPIRIT

Thanks in part to detailed flood preparations and disaster planning before the threat arrived, the MTS network and our portion of Canada's national telecommunications network suffered no significant damage throughout the many weeks of the flood.

The Company's outstanding effort during the crisis was recognized with a special award from the Canadian Business Telecommunications Alliance.

NETWORK IMPROVEMENTS

In addition to protecting the MTS network during 1997, we also made several noteworthy improvements to it and to the services we provide.

We continued the rollout of enhanced 9-1-1 service in 1997 as more communities outside Winnipeg enrolled in the program; the number of lines with access to the service doubled over the past year. In addition to bringing quick emergency response to more MTS customers, enhanced 9-1-1 also increases a revenue stream for the Company, since the participating communities' emergency services use our *FleetNet 800* group communications service.

In March, we also announced a new, improved telephone service for communities in northern Manitoba. The new satellite service, Telephony Earth Station (TES), provides better reliability and voice quality, and the ability to use higher-speed fax technology.

YEAR 2000 READINESS

Due to the manner in which computers and other date-sensitive electronic equipment store numbers related to the year (storing years as two digits instead of four), businesses could experience a disruption of operations with the arrival of the year 2000.

Ensuring that our systems and networks are ready and problem-free for the year 2000 is a top priority at MTS. Our products and services are provided on complex computerized networks that interconnect with numerous internal systems and with other telecommunications carriers in Canada and beyond. To ensure that business processes continue to operate efficiently, MTS project teams have been preparing for the year 2000 since early 1996, and are collaborating with other Stentor companies to coordinate year 2000 readiness activities.

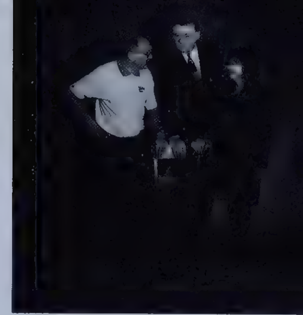
MTS completed a year 2000 Business Impact Assessment in 1996. Conversion of critical systems is already well underway and on schedule for completion by September 30, 1998.

In addition, a vendor management program has been implemented. All suppliers have been contacted and MTS is working with them to ensure continuity of service to our customers. And although we don't anticipate any difficulties, contingency plans have been developed for critical business processes.

A NETWORK THAT'S THERE WHEN WE NEED IT: RELIABILITY IS A KEY FOCUS EVERY DAY FOR MTS NETCOM EMPLOYEES LIKE GORD KEITH, REGIONAL GENERAL MANAGER CUSTOMER SERVICE; AND RIEK GLADYS, FIELD SERVICE TECHNICIAN. DURING THE HISTORIC FLOOD OF '97, MTS CORPORATE EMERGENCY PLANNING MANAGER MARY GENYK HELPED COORDINATE THE EFFORT THAT KEPT THE MTS NETWORK UP AND RUNNING DURING THE WORST MOTHER NATURE HAD TO OFFER. AND WHAT'S RELIABILITY WITHOUT SERVICE? EMPLOYEES LIKE MTS NETCOM PHONE REPRESENTATIVE SHIRLEY TINSLEY DELIVER SERVICE THAT IS SECOND TO NONE.

THE FUTURE IS
OURS TO SHARE

Of the many telecommunications companies operating in Manitoba, none comes close to matching our community spirit. We are an integral part of the communities we serve, playing a vital role in the Manitoba economy and in the social, cultural, educational, and sporting lives of its citizens. MTS was proud to take an active role in a wide range of community activities in 1997. During the flood, hundreds of MTS employees and their families volunteered their time to help friends and neighbours battle the Red River.



Proud to be a part of the communities we serve: Manitoba Telecom Pioneers Chapter 50 President, Bob McNaughton, Wayne Wilson Executive Director Pan Am Games Project, and Employees' Charity Trust Chairperson Krista Deighton exemplify the community spirit so typical of MTS's active and retired employees.

COMMUNITY SPIRIT

Of the telecommunications companies now operating in Manitoba, none comes close to matching MTS's community spirit. MTS is, in fact, an integral part of the communities we serve, and plays not only a vital role in the Manitoba economy, but also in the social, cultural, educational, and sporting lives of those who, like us, are proud to call Manitoba home.

Over the past year, MTS contributed to the overwhelming success of the Canada Games in Brandon, while continuing preparations related to our role as proud partner and official telecommunications supplier to the 1999 Pan Am Games. MTS also made significant contributions to the Manitoba arts community through a number of sponsorships associated with the Winnipeg Symphony Orchestra, Manitoba Theatre Centre, and the world-renowned Royal Winnipeg Ballet.

EMPLOYEES WHO CARE

MTS's commitment to the community extends far beyond the sponsorship of special events, however. During the flood, hundreds of MTS employees volunteered their time, helping friends and neighbours battle the Red River. Our willingness to help those in need was also evident in MTS Mobility's role as a founding partner in Victims First, the first program of its kind in Canada, which provides cell phones at no cost to domestic violence victims in high-risk situations.

As in years past, MTS's community involvement was complemented by the MTS Pioneers, a volunteer group of retired and active employees, who once again dedicated thousands of hours to worthwhile community endeavors throughout the province. Together, we remain committed to helping make Manitoba an even better place to live, work, and play.

The commitment MTS employees have demonstrated for their community was also reflected in the results of the 1997 Employees' Charity Trust (ECT) campaign – where funds raised will be divided among the United Way, the Heart and Stroke Foundation of Manitoba, the Salvation Army, the Canadian Cancer Society, and other Manitoba charities.

MTS employees' concern for the community we live and work in is also reflected in our continuing dedication to the principles set out in MTS's Environmental Policy.

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following Management Discussion and Analysis (MD&A) offers a detailed examination of 1997 operating and financial results. It also looks at the year ahead, the regulatory environment, and management's expectations for revenues and expenses.

The MD&A should be read in conjunction with the audited consolidated financial statements.

OVERVIEW

1997 was a year in which MTS took advantage of growth opportunities in its markets in order to address increasing competition and strengthen its financial position. On January 7, 1997, the Company was converted from a provincially-owned Crown corporation to a publicly-traded company. The Province of Manitoba converted $400 million of long-term debt owed to it by MTS into 70 million Common Shares, and one Special Share. The Province then sold the Common Shares to the public at $13.00 per share. This reduced the Company's long-term debt by $400 million and increased shareholders' equity by $400 million, significantly strengthening the Company's financial position. Following this recapitalization, MTS's debt ratio improved from 75.7% to 36.8%.

	1997	1996	% Change
Operating results *(in thousands)*:			
Operating revenues	$ 620,153	$ 589,325	5.2
Operating expenses	$ 505,171	$ 484,582	4.2
EBITDA (1)	$ 305,570	$ 296,044	3.2
Income before extraordinary item (2)	$ 84,664	$ 75,700	11.8
Net income (2)	$ 56,414	$ 75,700	(25.5)
Earnings per common share:			
Earnings before extraordinary item (2)	$ 1.21	$ 1.08	12.0

(1) Earnings before interest, income taxes, depreciation and amortization, and extraordinary item.

(2) Income before extraordinary item and net income for 1996 have been calculated on a pro forma basis, as though the application of the Company's sinking fund assets against the long-term debt and the conversion of $400 million of long-term debt due to the Province of Manitoba into 70 million Common Shares and one Special Share had occurred on January 1, 1996. For the purpose of this calculation, net income has been increased by $43.3 million, which represents the elimination of the 1996 interest expense and administration fee on the $400 million of converted long-term debt, net of the interest income that otherwise would have been earned on the sinking fund.

In 1997, the Company recorded $620.2 million in operating revenues representing an increase of $30.8 million or 5.2% over 1996 results. Income before an extraordinary item increased significantly to $84.7 million, representing an 11.8% increase over the previous year when compared on a pro forma basis. This growth in both revenues and earnings is attributable to local rate increases and continuing strong growth in the Company's Mobility business, telecommunications-related services, and online multimedia markets.

Operating costs increased marginally over 1996, due in part, to increased levels of business. Certain other costs incurred during the year, such as flood damage prevention activities and Year 2000 compliance initiatives, also contributed to the increase. Without these expenses, operating costs declined slightly in 1997.

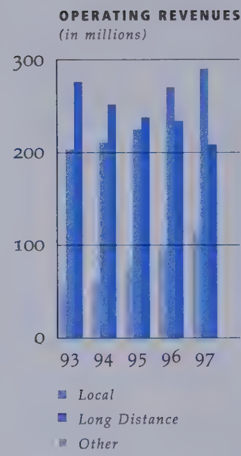
A one-time non-cash extraordinary item in the amount of $28.3 million was included in net income for 1997, which resulted from the discontinuance of regulatory accounting practices and the adoption of generally accepted accounting principles. This change in accounting practices, which is consistent with the actions of other Stentor members, was adopted in recognition of the competitive and regulatory changes in the telecommunications industry arising from decisions of the Canadian Radio-television and Telecommunications Commission (CRTC) to implement price cap regulation and local service competition effective January 1, 1998. This change has no effect on MTS's cash flow or its ability to pay dividends, nor is it expected to impact the Company's creditworthiness.

This extraordinary item was caused by the elimination of regulatory assets from the balance sheet pursuant to a change in the regulatory environment. These regulatory assets consisted of deferred costs related to workforce reduction programs which, at the direction of the CRTC, were being charged to income over a period of five years. The costs associated with past workforce reduction programs amounted to $13.8 million.

As part of its continuing efforts to maintain its status as a low cost provider of telecommunications services, MTS committed to further workforce reduction initiatives in the fourth quarter of 1997 which were implemented early in 1998. The costs of this program, which amounted to $14.5 million, were also included in the extraordinary item.

RESULTS OF OPERATIONS

OPERATING REVENUES



A key strength for MTS is its well diversified revenue base. As a full-service telecommunications provider, revenues are generated from a number of different services within the Company's portfolio. This is important, as it has allowed the Company to increase total operating revenues through the introduction and growth of newer telecommunications services, such as Mobility services, online multimedia services, and telecommunications-related services, despite flat to declining revenues generated by some of its traditional services, such as long distance.

The shift from reliance on revenues from traditional services to other services continued in 1997, as evidenced by the strong growth in Other service revenues, which increased by 25.9% in 1997. The Company has continued to take advantage of opportunities in the growth areas of Mobility, online multimedia and, more recently, telecommunications-related services, which involves exporting MTS's technical expertise and operational proficiency primarily to the United States. This initiative generated $10 million in new revenue during 1997.

LOCAL SERVICE REVENUES

	1997	1996	% Change
Revenues *(in thousands)*	$ 290,893	$ 262,711	10.7
Network access lines	679,303	666,910	1.9

Local service revenues increased by 10.7% or $28.2 million to $290.9 million in 1997, from $262.7 million in 1996. This increase is primarily due to a $2 per month rate increase per access line which was implemented on January 1, 1997 pursuant to a CRTC decision, and the consolidation of the ten rate groups in Manitoba into three, which was implemented in mid-1996. An increase in the number of network access lines, together with a 16% increase in revenue from enhanced services, also contributed to the increase in local service revenues for the year.

LONG DISTANCE REVENUES

	1997	1996	% Change
	(in thousands)		
Revenues	$ 211,930	$ 233,428	(9.2)
Conversation minutes	755,046	739,135	2.2

Competition increased in all segments of Manitoba's long distance market in 1997. MTS moved aggressively to address competitive pressures in the market during the year, and introduced two new long distance savings plans, *First Rate* and *Business Cents*, for residence and small business customers, respectively. These plans have been tailored specifically for Manitobans' calling patterns, and provide the most attractive pricing available in the province. MTS also implemented enhancements to its long distance offerings for large customers during the year. Although the aggressive pricing actions in the marketplace resulted in a 9.2% decrease in the Company's long distance revenues, they had the effect of stimulating long distance usage, so that total long distance minutes carried by MTS increased by 2.2% in 1997. As the preferred long distance provider in Manitoba with an estimated 75% market share at December 31, 1997, MTS is positioned well to compete successfully in the long distance market in the future.

OTHER REVENUES

	1997	1996	% Change
	(in thousands)		
Mobility	$ 71,993	$ 58,081	24.0
Directory	27,767	27,339	1.6
Internet	4,121	1,505	173.8
Miscellaneous	13,449	6,261	114.8
	$ 117,330	$ 93,186	25.9
Cellular customers	104,826	86,256	21.5
Internet customers	20,500	10,100	103.0
Cellular revenue per customer per month	$ 61.65	$ 71.23	(13.4)
Mobility EBITDA *(in thousands)*	$ 36,010	$ 29,621	21.6

Other revenues increased by 25.9% to $117.3 million as a result of significant growth in the Company's Mobility and Internet customer bases, as well as the expansion of telecommunications-related services which generated $10 million in new revenues for 1997. The Company continued to lead the Manitoba wireless market in sales, service and coverage with an estimated 70% market share. MTS also continued its success as the largest commercial Internet service provider in Manitoba.

OPERATING EXPENSES

	1997	1996	% Change
	(in thousands)		
Operations	$ 323,639	$ 305,859	5.8
Depreciation and amortization	181,532	178,723	1.6
Operating expenses	$ 505,171	$ 484,582	4.2

Operating expenses increased by $20.6 million or 4.2%, primarily due to approximately $16 million in expenses associated with the growth in Mobility, Internet, and telecommunications-related services. Flood damage prevention and Year 2000 compliance costs added to the increase. When these expenses are excluded, operations expense decreased slightly in 1997. Depreciation and amortization increased by $2.8 million or 1.6%, due to increased amortization of dealer commissions arising from growth in the cellular business.

DEBT CHARGES

	1997	1996	% Change
Debt charges *(in thousands)*	$ 36,706	$ 84,921	(56.8)
Average weighted cost of debt at year end	7.5%	8.9%	(15.7)

Debt charges decreased by $48.2 million or 56.8% in 1997. This decrease is due to the reduction in long-term debt that occurred when the Company was recapitalized on January 7, 1997, which involved the conversion of $400 million of long-term debt into share capital. This conversion also contributed to reduced debt charges by reducing the weighted average cost of debt. For comparative purposes, if the conversion of debt to common shares had occurred on January 1, 1996, the debt charges for 1996 would have decreased to $39.4 million. On a pro forma basis, debt charges decreased as a result of a $52.6 million reduction in debt outstanding since January 7, 1997.

LIQUIDITY AND CAPITAL RESOURCES

CASH FLOW FROM OPERATIONS

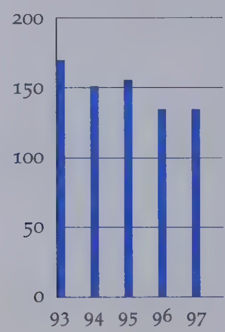
	1997	1996	% Change
	(in thousands)		
Cash provided by operating activities	$ 253,043	$ 186,928	35.4
Dividends	$ 47,600	—	—

Cash provided by operating activities increased by $66.1 million or 35.4%, primarily due to a reduction in interest expense relating to the conversion of $400 million of long-term debt into share capital and an improvement in income from operations.

The Company's Board of Directors has established a policy of paying quarterly cash dividends to the holders of MTS's Common Shares. In accordance with this policy, dividends of $0.17 per share were declared in each quarter of 1997, which amounted to a total of $47.6 million. Prior to its conversion to a publicly-traded corporation from a Crown corporation, the Company did not pay dividends.

INVESTING ACTIVITIES

CAPITAL EXPENDITURES
(in millions)



	1997	1996	% Change
	(in thousands)		
Cash used for investing activities	$ 133,547	$ 124,430	7.3

Cash used for investing activities consisted primarily of construction program expenditures which were consistent with 1996 levels. Capital expenditures for 1997 were less than anticipated due to delays and deferrals resulting from massive spring flooding which occurred throughout the Red River valley in Manitoba.

FINANCING ACTIVITIES

	1997	1996
	(in thousands)	
Cash used for financing activities	$ 53,875	$ 17,738

Cash used for financing activities represents net repayments of long-term debt during 1997. MTS implemented a medium term note program in 1997, pursuant to which it can issue notes periodically over a two-year period up to a maximum aggregate total value of $250 million. In 1997, MTS issued one medium term note in the amount of $80 million at a rate of 6.5%. The funds resulting from this issue, together with internally-generated cash of $53.9 million, were used to repay long-term debt due to the Province of Manitoba and the long-term trade payable.

CREDIT RATINGS

MTS's current credit ratings are as follows:

	Senior Debentures	Commercial Paper
Canadian Bond Rating Service	A	A-1
Dominion Bond Rating Service	A(low)	R-1(low)

The Company's recapitalization, which resulted in the conversion of $400 million of long-term debt into equity, significantly strengthened the Company's capital structure. The Debt Conversion and Repayment Agreement dated January 7, 1997, between the Province of Manitoba and the Company requires the repayment of the remaining debt owed by MTS to the Province by December 31, 2000, in amounts between $80 million and $125 million per year. To facilitate this refinancing, in addition to its medium term note program, the Company has arranged a credit facility of $25 million with a Canadian chartered bank, and has implemented a commercial paper program authorized to a maximum of $100 million. These arrangements will ensure adequate liquidity to meet the Company's working capital needs. There were no amounts outstanding against these credit facilities as at December 31, 1997.

OUTLOOK

This outlook and certain other sections of this report contain forward-looking statements with respect to MTS. These forward-looking statements, by their nature, necessarily involve risks and uncertainty that could cause actual results to differ materially from those contemplated by the forward-looking statements.

As a major regional full-service telecommunications provider operating primarily in Manitoba, MTS is affected by economic conditions that impact its broad base of residence and business customers throughout Manitoba. The provincial economy has been performing solidly in recent years, with 1996 growth in gross domestic product of 2.9%, which was the second best growth rate among Canadian provinces, and was nearly twice the national average of 1.5% for 1996. Similar results are anticipated for 1997. The economic outlook for 1998 is for continued growth and stable market conditions in Manitoba. This is expected to have a favourable impact on the Company's business performance.

OPERATIONS

Management expects to deliver improved financial performance in 1998 based on an overall increase in revenues and an aggressive approach to improving efficiencies on the cost side. A key element in the Company's corporate strategy is to generate increased revenues in growing business areas, such as Mobility, Internet-related services, and telecommunications-related services. These businesses continue to contribute an increasing proportion of MTS's net income.

Local revenues are expected to increase slightly, net of the price cap index reductions, due to rate increases and growth in network access lines and enhanced services. In a decision issued on December 18, 1997, the CRTC established interim going-in rates for each telephone company in the Stentor alliance by approving interim local rate increases to take effect on January 1, 1998. The CRTC approved an interim local rate increase in the amount of $0.35 per month for MTS. The CRTC's final decision on all issues in this proceeding, including final local rate increases, is expected in March 1998.

MTS has moved aggressively to address the significantly heightened competition that developed in the long distance market during the year by introducing new pricing structures in residence and small business long distance market segments. With the CRTC's decision to forbear regulating long distance services in 1998, MTS plans to respond aggressively to competitive actions. This strategy was illustrated in early 1998 with the implementation of significant reductions to the Company's *First Rate* long distance savings plan. While these actions are expected to decrease 1998 long distance revenues net of stimulation, the declines will be more than offset by growth in revenues from other parts of the Company's business. MTS is the preferred long distance supplier in Manitoba with an estimated 75% market share at year-end 1997.

Increased call centre activities are also expected to partially offset the decrease in long distance revenues. Two significant call centre customers were announced in the last three months and will represent a total of 700 seats when fully operational. This growing industry will continue to be a focus for MTS in the future.

Management expects further growth in Mobility revenues resulting from increased market penetration; the introduction of Personal Communications Services (PCS), the Company's new digital wireless service; and the expansion of *FleetNet 800* services, a new group communications service featuring an enhanced trunked radio dispatch network. In December 1997, MTS introduced PCS to its top 300 customers. The Company will formally launch PCS in the first quarter of 1998. On January 14, 1998, MTS announced the signing of a ten-year contract with the RCMP for the provision of province-wide *FleetNet 800* services,

which is expected to generate revenues of approximately $60 million. The wireless market continues to provide exciting growth opportunities and MTS will continue to aggressively pursue these opportunities.

The Internet and other online multimedia initiatives are expected to provide increased revenues in 1998 through increased market penetration for Internet access services and the introduction of new Internet-based services. MTS continued to lead the way as the largest commercial Internet service provider in Manitoba. In the last quarter of 1997, the Company introduced two new innovative Internet-based services. *ngage,* MTS's electronic commerce service, provides businesses with a secure means to easily sell products, services, and information on the Internet, while *BeyondTV* brings the Internet to the television. Both of these new services are national offerings and are consistent with the Company's strategy of growing beyond Manitoba's borders.

Consistent with its ongoing strategy to maintain MTS's status as a low cost service provider, MTS Net and MTS Com, the two divisions comprising the Company's largest operating subsidiary, MTS NetCom Inc., were combined to realize synergies, reduce duplication of efforts, and provide better service to customers. On January 19, 1998, management announced a voluntary termination incentive program aimed at reducing staff in MTS NetCom Inc., by approximately 350 positions. This initiative is intended to contribute to the operating cost efficiency objectives that have been set for 1998.

The Company's products and services are provided on complex computerized networks that interconnect with internal information systems. Ensuring that these systems and networks continue to operate efficiently is critical to the future success of MTS. A thorough Year 2000 business impact assessment was completed in 1996, and a detailed action plan was developed and implemented to address all issues which were identified. All critical information systems and networks are scheduled to be converted by September 30, 1998, and progress to date is in accordance with the action plan. Further testing and implementation of non-critical systems will continue into the early part of 1999.

Costs are being treated in accordance with generally accepted accounting principles which only allow the capitalization of costs in cases where the service potential of a capital asset is enhanced. Regular upgrades of the network and planned enhancements to certain information systems included as part of the $170 million 1998 capital program will result in Year 2000 compliance for these networks and systems without any additional effort. In addition, incremental operating costs associated with MTS's Year 2000 plan, which are written off as incurred, were approximately $5 million to December 31, 1997, while an additional $7 million will be incurred during 1998. The costs involved to complete this task have been included in MTS's financial projections for 1998, and will not prevent MTS from delivering solid growth in earnings.

In addition, a vendor management program has been implemented. All suppliers have been contacted and MTS is working with them to ensure continuity of service to our customers. MTS is also working closely with its Stentor partners to ensure that telecommunications carriers with which the MTS network interconnects have appropriately addressed their Year 2000 issues. There can be no assurance that the products or services of other companies which MTS or its customers utilize, or on which they rely, will be converted in a timely and effective manner, or that a failure to convert by another company, or a conversion that is incompatible with the MTS systems, would not have a material adverse effect on MTS or its customers. Although MTS does not anticipate any difficulties, contingency plans have been developed for critical business processes.

LIQUIDITY AND CAPITAL RESOURCES

Planned capital expenditures for 1998 are $170 million. Capital programs include enhancing and growing the MTS digital network, expanding the PCS network, investing in the *FleetNet 800* network, expanding data and integrated services networking capabilities, investing in management information systems, and further developing the Company's online multimedia infrastructure to serve its expanding base of Internet and electronic commerce customers. These capital expenditures are expected to be fully financed from internally-generated funds.

Management expects to utilize its medium term note program to continue to replace debt that is repaid to the Province of Manitoba under the terms of the Debt Conversion and Repayment Agreement.

The Board of Directors of MTS, in accordance with its policy of paying quarterly dividends to holders of MTS's Common Shares, declared a first quarter 1998 dividend of $0.17 per common share. It is anticipated that internally-generated funds will be sufficient to fully fund dividend payments in 1998. In addition to paying dividends and funding capital expenditures, MTS expects to generate free cash flow in 1998.

REGULATORY ENVIRONMENT

The competitive and market environment in which MTS operates is governed by the CRTC, which regulates telecommunications carriers under the authority of the *Telecommunications Act* (Canada). The CRTC has authority over certain aspects of the operations of telecommunications common carriers including rates, service packages, quality of service, costing, and accounting practices. The *Telecommunications Act* (Canada), however, obliges the CRTC to forbear from the regulation of rates and service conditions where it determines that there is sufficient competition to protect the interests of consumers.

MTS NetCom Inc. is regulated by the CRTC as a telecommunications common carrier. MTS NetCom Inc. replaced MTS as the common carrier in Manitoba when MTS transferred its telephone company operations and assets to MTS NetCom Inc. as part of the restructuring of the Company, which became effective January 1, 1996.

As a result of Review of Regulatory Framework, Telecom Decision CRTC 94-19, the CRTC split MTS NetCom Inc.'s rate base into utility and competitive business segments. The utility segment includes most of MTS NetCom Inc.'s local services. The competitive segment includes long distance, data and terminal service offerings which are subject to competition in the marketplace. MTS NetCom Inc. is required to file tariffs for its local and some of its competitive services, and to demonstrate that the prices for tariffed services cover their costs and underlying charges.

In December 1997, the CRTC issued Forbearance — Regulation of Toll Services Provided by Incumbent Telephone Companies, Telecom Decision CRTC 97-19, which changed the manner of regulation of long distance voice services provided by the Stentor telephone companies. Subject to certain limited exceptions, existing tariffs for regional long distance services will be withdrawn effective January 28, 1998, and existing tariffs for national long distance services will be withdrawn by March 16, 1998, which means that MTS NetCom Inc. will be permitted to offer toll services to customers at rates that do not have to be approved by the CRTC. This change places MTS on the same footing as its long distance competitors, and increases the Company's speed and flexibility to compete in the long distance market. Going forward, the Company will be allowed to offer prices and services specifically tailored to individual customer needs.

The CRTC maintains the authority to impose general conditions on the provision of cellular and wireless voice services to prevent unjust discrimination and the conferring of undue preferences. However, the CRTC has relieved MTS Mobility of the requirement to file tariffs for its services. MTS NetCom Inc. and MTS Mobility Inc. currently are restricted from joint marketing, joint billing and bundling their services, although the CRTC has initiated a proceeding to determine the continued appropriateness of these restrictions.

Effective January 1, 1998, the CRTC implemented a price cap regulatory mechanism for the telephone companies' utility segments. The price cap regime replaces earnings regulation, under which the companies were allowed to earn a specific rate of return on their utility segments. Under a price cap regime, utility services are grouped into a number of service baskets. The initial prices for each basket will be capped, after which annual price changes will be adjusted by an inflation factor and a pre-determined productivity offset of 4.5%. Price cap regulation will apply only to local utility services, and is intended as an interim form of regulation as the market in local telephone services becomes more competitive.

The CRTC has also opened up the market for local telephone service to competition effective January 1, 1998, pursuant to Price Cap Regulation and Related Issues, Telecom Decision CRTC 97-9. In preparation for local competition, the telephone companies are required to unbundle the essential components of their local service facilities and equipment. These components will be made available to competitors at tariffed rates. This is intended to permit new entrants to provide competitive local services without completely replicating the local networks of the existing telephone companies. Competitors are also permitted to enter the local services market by reselling MTS NetCom Inc.'s local services, although no discount will be provided to these resellers. Local resellers currently are operating in the Winnipeg market. In addition, at least one facilities-based local service provider has announced its intention to provide service in Winnipeg's downtown core beginning in the fourth quarter of 1998.

The federal government's Convergence Policy Statement issued in August 1996 announced that competition in the broadcast industry will be permitted on the same timetable as competition in local telephone service. Telephone companies, including MTS NetCom Inc., will be allowed to hold broadcast licenses beginning January 1, 1998.

CONSOLIDATED FINANCIAL STATEMENTS

MANAGEMENT'S RESPONSIBILITY FOR CONSOLIDATED FINANCIAL STATEMENTS

The accompanying consolidated financial statements of Manitoba Telecom Services Inc. and the information in the annual report are the responsibility of management and have been approved by the Board of Directors.

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles, and necessarily include some amounts that are based on management's best estimates and judgements. Financial information presented elsewhere in the annual report is consistent with that in the consolidated financial statements.

In fulfilling their responsibilities, management have developed and continue to maintain a system of internal controls including written policies and procedures, segregation of duties and responsibilities, and an internal audit program. This system is designed to provide reasonable assurance that assets are adequately accounted for and safeguarded, transactions are properly authorized and recorded, and the financial records are reliable for preparing the consolidated financial statements.

The Board of Directors carries out its responsibility for the consolidated financial statements in the annual report principally through its Audit Committee. The Audit Committee meets periodically with management and with the internal and external auditors to discuss the results of audit examinations with respect to the adequacy of internal controls and to review and discuss the consolidated financial statements. The Audit Committee recommends the consolidated financial statements to the Board for approval.

The consolidated financial statements have been audited by Deloitte & Touche, Chartered Accountants, who have full access to the Audit Committee, with and without the presence of management. Their report follows.

Bill Fraser
President & Chief Executive Officer

Cheryl Barker
Vice President Finance & Chief Financial Officer

AUDITORS' REPORT

To the Shareholders
Manitoba Telecom Services Inc.

We have audited the consolidated balance sheets of Manitoba Telecom Services Inc. as at December 31, 1997 and 1996, and the consolidated statements of income and retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and 1996, and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Deloitte & Touche

Chartered Accountants
Winnipeg, Manitoba
January 29, 1998

CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

	Years Ended December 31 1997	1996
	(in thousands)	
OPERATING REVENUES		
Local service	$ 290,893	$ 262,711
Long distance service	211,930	233,428
Other	117,330	93,186
	620,153	589,325
OPERATING EXPENSES		
Operations	323,639	305,859
Depreciation and amortization	181,532	178,723
	505,171	484,582
Net operating revenues	114,982	104,743
Other income	9,056	12,578
Debt charges (Note 6)	36,706	84,921
Income before income taxes and extraordinary item	87,332	32,400
Income tax expense (Note 7)	2,668	—
Income before extraordinary item	84,664	32,400
Extraordinary item, net of tax (Note 13)	28,250	—
Net income	56,414	32,400
Retained earnings, beginning of year	265,140	232,740
Premium on debt conversion (Note 10 (a))	11,140	—
Dividends on common shares	47,600	—
Retained earnings, end of year	$ 262,814	$ 265,140
Earnings per common share (Note 15)		(pro forma)
Earnings before extraordinary item	$1.21	$1.08
Net earnings	$0.81	$1.08

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Years Ended December 31 1997	1996
	(in thousands)	
OPERATING ACTIVITIES		
Net income	$ 56,414	$ 32,400
Depreciation and amortization	181,532	178,723
Cash used for changes in working capital	(696)	(945)
Payments towards deferred employee benefits	(2,048)	(5,070)
Extraordinary item	28,250	—
Other items	(10,409)	(18,180)
Cash provided by operating activities	253,043	186,928
Dividends	(47,600)	—
INVESTING ACTIVITIES		
Establishment of new pension plan:		
Contribution of investments held for pension obligations to pension plan trust fund	343,006	—
Transfer of pension obligations to pension plan trust fund	(343,006)	—
Construction program expenditures (net)	(134,630)	(135,199)
Increase in investments held for pension obligations	—	(29,131)
Earnings on investments held for pension obligations	—	43,542
Decrease (increase) in investments	1,083	(3,642)
Cash used for investing activities	(133,547)	(124,430)
Free cash flow	71,896	62,498
FINANCING ACTIVITIES		
Recapitalization:		
Sinking fund withdrawals	34,816	—
Application of sinking fund to long-term debt	(34,816)	—
Shares issued on conversion of long-term debt	400,000	—
Long-term debt converted to share capital	(400,000)	—
Issuance of long-term debt	80,000	140,401
Repayment of long-term debt	(132,638)	(162,597)
Sinking fund withdrawals	—	16,536
Contribution to sinking fund	—	(10,476)
Decrease in long-term trade payable	(1,237)	(1,602)
Cash used for financing activities	(53,875)	(17,738)
Increase in cash	18,021	44,760
Cash, beginning of year	50,701	5,941
Cash, end of year	$ 68,722	$ 50,701

CONSOLIDATED BALANCE SHEET

ASSETS

	December 31 1997	1996
	(in thousands)	
CURRENT ASSETS		
Short-term investments	$ 68,722	$ 50,701
Accounts receivable	97,530	95,997
Prepayments	10,870	10,347
	177,122	157,045
PROPERTY, PLANT AND EQUIPMENT		
Buildings, plant and equipment	2,140,228	2,144,590
Less: accumulated depreciation	1,141,254	1,121,896
	998,974	1,022,694
Land	6,453	6,281
Plant under construction	24,022	24,648
Materials and supplies	6,827	10,650
	1,036,276	1,064,273
OTHER ASSETS		
Investments (Note 3)	11,711	16,795
Deferred charges (Note 4)	11,832	26,998
Investments held for pension obligations (Note 8(b))	—	343,006
	23,543	386,799
	$ 1,236,941	$ 1,608,117

LIABILITIES AND SHAREHOLDERS' EQUITY

	December 31 1997	1996
	(in thousands)	
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$ 124,007	$ 100,036
Advance billings and payments	19,027	17,537
Accrued interest	10,982	25,583
Debt due within one year (Note 9)	80,000	178,813
	234,016	321,969
LONG-TERM DEBT (NOTE 10)		
Advances and note payable	296,886	673,685
Premium on long-term debt	8,420	—
Less: sinking fund assets	—	25,694
	305,306	647,991
OTHER LIABILITIES		
Long-term trade payable	1,876	3,113
Deferred employee benefits (Note 5)	32,929	369,904
	34,805	373,017
Total liabilities	574,127	1,342,977
Shareholders' equity		
Share capital (Note 11)	400,000	—
Retained earnings	262,814	265,140
	662,814	265,140
	$ 1,236,941	$ 1,608,117

Approved on behalf of the Board

Chairman

Director

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 1997 and 1996

1. REORGANIZATION

a. The *Manitoba Telephone System Reorganization and Consequential Amendments Act* (the Reorganization Act) was passed by the Legislature of the Province of Manitoba (the Province) on November 28, 1996. Upon the proclamation of the Reorganization Act on January 7, 1997, the following significant events and transactions became effective:

i. The Manitoba Telephone System was continued as a share capital corporation operating under the name Manitoba Telecom Services Inc. The term "Company" is used to mean Manitoba Telecom Services Inc. and, where the context of the narrative permits, its subsidiaries.

ii. The Company's indebtedness to the Province was refinanced pursuant to the terms of the Debt Conversion and Repayment Agreement between the Company and the Province. Under the terms of this agreement the Province applied the sinking fund assets of the Company against the debt owed to it by the Company and then converted $400 million of the debt into 70 million Common Shares and a Special Share of the Company.

Accordingly, the shareholders' equity of the Company increased by $400 million and the long-term debt decreased by $400 million.

iii. The Province sold the 70 million Common Shares to the public for cash consideration of $13.00 per share under a prospectus offering. No portion of the proceeds has been or will be received by, nor will the related costs of the offering be incurred by the Company.

iv. Subsequent to the sale of the Common Shares to the public, the tax status of the Company and each of its subsidiaries changed from being a tax-exempt entity to being a taxable corporation.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. *General*

The Company operates in a single industry segment which is telecommunications services. The Company's principal subsidiary, MTS NetCom Inc. (NetCom), is regulated under the *Telecommunications Act* by the Canadian Radio-television and Telecommunications Commission (CRTC). Up until December 31, 1997, in its role as regulator, the CRTC set the allowed rate of return, and approved tariffs and interconnection and working agreements with other carriers. It also periodically issued directives that affected the accounting treatment of specific items in the Company's accounts. Telecom Decision CRTC 97-9 establishes a price cap regulatory framework that will replace, effective January 1, 1998, the current rate base/rate of return regulatory framework for the utility segments of NetCom. Under this new framework, NetCom's residence services and single line and multiline business services, as well as certain other access services, will be grouped into a single basket of services that will be subject to price regulation through a price cap formula.

The financial statements of the Company for periods ended up to and including December 31, 1997, have been prepared in accordance with generally accepted accounting principles (GAAP) including provisions for regulatory accounting practices similar to those being used in the Canadian telecommunications industry. The Company determined that it no longer meets the criteria necessary for the continued application of regulatory accounting practices as a result of the introduction of price cap regulation and the opening of the local exchange market to competition. Accordingly, the Company's accounting policies, while continuing to be in accordance with GAAP, no longer include regulated accounting treatment.

The Company, based on the foregoing events, has adjusted the net carrying values of assets and liabilities as at December 31, 1997, to reflect values that would be appropriate under GAAP for enterprises subject to price cap regulation. The adjustment has been recorded in the December 31, 1997, financial statements as an extraordinary item (Note 13).

b. *Consolidation*

The consolidated financial statements include the accounts of the Company and its subsidiaries, namely MTS NetCom Inc., MTS Mobility Inc., MTS Advanced Inc., Manitoba Telecom Services International Inc., and ViewCall Canada Inc.

c. *Deferred charges*
Deferred charges includes deferred commissions which are amortized over the period of expected benefits and, prior to December 31, 1997, the costs associated with employee reduction programs which were deferred and amortized over five years (Note 2(a)).

d. *Property, plant and equipment*
Property, plant and equipment is recorded at original cost including materials, direct labour and certain overhead costs associated with construction activity and an allowance for the cost of funds during construction. Interest included in Construction program expenditures during 1997 was $1,172,000 (1996 - $1,231,000).

e. *Depreciation*
Depreciation is calculated on a straight-line basis over the estimated useful life of property, plant and equipment by applying rates that are based on a continuing program of engineering studies. The composite depreciation rate for the year ended December 31, 1997 was 7.6% (1996 - 7.7%).

f. *Translation of foreign currencies*
Foreign currencies have been translated into Canadian dollars at rates of exchange on the following basis:

i. Monetary assets and liabilities at effective rates prevailing at the end of the year;

ii. Revenues and expenses at rates prevailing at the respective transaction dates.

g. *Amortization of long-term debt costs*
Costs associated with the issuance of long-term debt are included in deferred charges and amortized over the term of the original issue.

h. *Financial instruments*
The Company's financial assets and liabilities are initially recorded at the related transaction amount, which is normally the historical cost. When the carrying value of a financial asset exceeds its fair value on a basis which is other than temporary, the carrying value is reduced to its fair value.

i. *Income taxes*
The Company uses the tax allocation basis of accounting for income taxes. Under this method, the provision for income taxes is based on accounting income included in the statement of income regardless of when such income is subject to tax.

j. *Pension costs and obligations*
The Company has a contributory defined benefit final average pension plan which covers all of its employees. The pension plan provides pensions based on length of service and final average earnings. Pension costs are determined using the projected benefit method prorated on years of service and based on management's best estimates. Adjustments to pension costs arising from plan amendments, changes in assumptions or experience gains and losses are amortized to income on a straight-line basis over the expected average remaining service life of pension plan participants. Market related values of pension fund assets are calculated using a three year moving average of year end market values. The cumulative difference between the amount contributed to the pension plan and the amount charged to income is recorded as part of deferred employee benefits.

k. *Post-employment benefits*
The Company provides certain group insurance benefits for employees on retirement. The cost of these benefits is determined by an independent actuary and has been included in operations expense. The actuarial value of the accrued post-employment benefits is unfunded and is recorded as part of deferred employee benefits.

3. INVESTMENTS

		1997		1996
		(in thousands)		
Investments carried at cost				
Long-term disability fund	$	4,129	$	3,885
Alouette Telecommunications Inc. shares		7,560		7,560
Other investments carried at equity		22		5,350
	$	11,711	$	16,795

The market value of the long-term disability fund at December 31, 1997 totalled $4,872,000 (1996 - $4,597,000).

4. DEFERRED CHARGES

		1997		1996
		(in thousands)		
Employee reduction program (Note 13)	$	—	$	13,449
Deferred commissions		9,997		12,978
Other		1,835		571
	$	11,832	$	26,998

Amortization expense amounted to $18,906,000 for the year ended December 31, 1997 (1996 - $13,331,000).

5. DEFERRED EMPLOYEE BENEFITS

		1997		1996
		(in thousands)		
Pensions (Note 8)	$	590	$	343,006
Other		32,339		26,898
	$	32,929	$	369,904

6. DEBT CHARGES

		1997		1996
		(in thousands)		
Interest on long-term debt	$	33,287	$	80,139
Amortization of long-term debt costs		29		23
Other interest expense and debt charges		3,390		4,759
	$	36,706	$	84,921

7. INCOME TAXES

Prior to January 7, 1997, the Company operated as a provincial Crown Corporation, and as such, was exempt from federal and provincial income taxes. As a result of the reorganization described in Note 1, the Company's operations became subject to income tax.

Effective January 7, 1997, the tax basis of certain of the Company's assets was established at an amount which exceeded the recorded carrying values. In addition, the Company received an advance federal income tax ruling respecting the tax deductibility of the Company's $383 million contribution to the Pension Plan during the year. The deduction of this contribution, among other items, resulted in a loss for tax purposes in 1997 that can be carried forward to reduce taxable income for the Company and its subsidiaries over a maximum period of seven years.

The portion of the loss carry-forward for tax purposes which has not been recognized in the financial statements amounts to $325 million. The benefit relating to the loss carry-forward will be realized over a period of years and recognized for accounting purposes in the years realized.

The provision for income taxes is analyzed in the following table to show the difference between the taxes that would be payable by applying statutory tax rates to pre-tax income and the taxes actually provided in the accounts.

	1997	%
	(in thousands)	
Income before income taxes and extraordinary item	$ 87,332	
Statutory income tax	$ 40,260	46.1
Large corporations tax	2,365	2.7
Adjusted for the effect of:		
realization of the benefit of losses and additional tax deductions	(40,260)	(46.1)
other	303	0.3
Income tax expense	$ 2,668	3.0

8. PENSIONS

a. *Pension plan*

Effective January 1, 1997, the Company established a new pension plan (the "new Pension Plan"), to be registered under the *Pension Benefits Standards Act*, 1985 (Canada), and registered under the *Income Tax Act* (Canada), which provides benefits that are equivalent in value, on the implementation date, to the pension benefits to which current and former employees of the Company and its subsidiaries and other beneficiaries have or may have become entitled under *The Civil Service Superannuation Act* (Manitoba) (Note 8(b)). As part of the establishment of the new Pension Plan, a trust fund was created by the Company which holds all monies and assets relating to the new Pension Plan.

The Company transferred its investments held for pension obligations, which had a market value at the time of transfer of approximately $383,000,000, to the new Pension Plan trust fund. As a result of this transfer, the investments held for pension obligations and the corresponding pension liability were removed from the Company's balance sheet.

During the year assets with a market value of $424,039,000 representing the share of total assets of The Civil Service Superannuation Fund (CSSF) that related to current and former employees of the Company were transferred from the CSSF to the new Pension Plan trust fund. The Company has sole responsibility for funding any deficiencies in the new Pension Plan that may arise.

Actuarial reports prepared for the Company estimate the actuarial value of the net assets available for benefits and the accrued pension benefits as at December 31, 1997, as follows:

	1997
	(in thousands)
Net assets available (at market related values)	$ 782,922
Accrued pension benefits	$ 789,889

b. *Pension plan prior to January 1, 1997*

Prior to January 1, 1997, employees of the Company were pensionable under the CSSF established under *The Civil Service Superannuation Act* (Manitoba), and made contributions to CSSF at prescribed rates. The CSSF was a defined benefit final average pension plan which covered all of the Company's employees. The CSSF provided pensions based on length of service and final average earnings.

Investments held to meet the Company's portion of the pension obligations were recorded at cost. The market value of investments at December 31, 1996 totalled $379,055,000. Based on an actuarial valuation completed January 1, 1995, the Company's portion of the liability for pension obligations at December 31, 1996 was approximately $359,166,000. This liability was based on the assumption that future pensions will be increased due to increases in the cost of living. The remaining portion of the pension assets and liability for pension obligations was held by the CSSF.

9. DEBT DUE WITHIN ONE YEAR

	1997	1996
	(in thousands)	
Advances due within one year (Note 10(a))	$ 80,000	$ 187,935
Less: sinking fund assets allocated to advances due within one year (Note 10(b))	—	9,122
Debt due within one year	$ 80,000	$ 178,813

10. LONG-TERM DEBT

a. *Advances and note payable*

	1997	1996
	(in thousands)	
Province of Manitoba Advances		
Series UFA30, 4.60%, due January 8, 1997	$ —	$ 3,819
Series BC, 8.75%, due February 5, 1997	—	3,704
Advance UFA3, 10.75%, due February 5, 1997	—	80,455
Advance UFA31, 4.10%, due March 31, 1997	—	57,957
Advance UFA6, 11.50%, due September 28, 1997	—	20,000
Advance UFA32, 5.15%, due October 1, 1997	—	22,000
Advance UFA7, 11.25%, due January 16, 1998	—	8,780
Advance UFA33, 5.42%, due March 31, 1998	56,625	56,625
Advance UFA20, 7.00%, due August 20, 1998	9,341	9,642
Advance UFA16, 9.00%, due June 5, 1999	7,166	7,484
Advance UFA17, 7.625%, due September 30, 1999	22,023	23,000
Advance UFA4, 11.5%, due June 29, 2000	—	20,000
Advance UFA5, 11.125%, due August 7, 2000	—	96,878
Advance UFA8, 10.375%, due April 26, 2001	—	40,000
Advance UFA9, 11.00%, due July 2, 2001	—	42,374
* Advance UFA12, 9.00%, due January 27, 2002	18,577	24,847
Advance UFA14, 9.25%, due March 27, 2002	—	40,000
Advance UFA15, 9.375%, due March 31, 2003	—	34,754
Advance UFA19, 8.50%, due May 14, 2003	—	18,129
Advance UFA18, 9.75%, due February 15, 2004	—	10,000
Advance UFA21, 8.25%, due July 2, 2004	—	7,484
Advance UFA11, 9.50%, due December 2, 2004	—	11,799
Advance UFA23, 7.75%, due March 1, 2005	9,695	25,374
Advance UFA25, 8.75%, due May 15, 2005	43,733	44,175
Advance UFA22, 7.75%, due September 30, 2005	15,501	16,000
Advance UFA28, 8.00%, due April 17, 2006	48,106	48,592
Advance UFA10, 9.75%, due November 15, 2006	—	14,150
Advance UFA24, 9.00%, due May 2, 2007	14,662	14,968
Advance UFA26, 8.50%, due September 29, 2007	11,880	12,000
Advance UFA13, 9.125%, due April 3, 2008	27,697	34,630
Advance UFA27, 8.625%, due September 8, 2010	11,880	12,000
	296,886	861,620
Note payable		
Medium Term Note, 6.5%, due July 2, 2007	80,000	—
	376,886	861,620
Less: portion due within one year	80,000	187,935
Total advances and note payable	$ 296,886	$ 673,685

* Annual partial repayments

Pursuant to the terms of the Debt Conversion and Repayment Agreement (Note 1), the Province of Manitoba Advances are now subject to substantially altered repayment terms and due dates. These Advances are secured by a floating charge against the assets of the Company. In the case of Advances with stated due dates prior to December 31, 2000, as listed above, repayment is required according to these stated due dates. In the case of Advances with stated due dates subsequent to December 31, 2000, as listed above, the Company has the option to repay Advances in whole or in part at any time before December 31, 2000. However, the Debt Conversion and Repayment Agreement requires minimum repayments of $80 million and allows maximum repayments of $125 million in each of the four years ending December 31, 1997, to December 31, 2000, irrespective of the original due dates. The right to repay up to $125 million in each year is non-cumulative.

All Advances must be repaid by December 31, 2000, and any Advances repaid that have a maturity date falling after December 31, 2000, must be repaid at market value at the date of repayment. As at January 7, 1997, the estimated excess of the market values of Advances over the book values at the anticipated time of repayment was $11.1 million. This original estimate of $11.1 million was assigned to specific Advances, accrued as a liability and charged directly to retained earnings of the Company. Any difference between this original estimate and the actual excess of market value over book value is charged to current operations as part of debt charges at the actual date of repayment. During 1997 debt premium payable of $2.7 million associated with Advances repaid during the year was relieved from the liability, leaving $8.4 million relating to outstanding Advances.

The Medium Term Note ranks *pari passu* with all Advances and is secured by a floating charge on the Company's assets.

b. *Sinking fund*

		1997		1996
		(in thousands)		
Sinking fund assets (Note 1)	$	—	$	34,816
Less: assets allocated to advances due within one year (Note 9)		—		9,122
	$	—	$	25,694

Under the requirements of *The Manitoba Telephone Act*, the Company was required to make a contribution to the Minister of Finance of the Province of Manitoba, as trustee for the sinking fund. The sinking fund contribution for the year ended December 31, 1996 was $10,476,000. The market value of the investments held in the fund at December 31, 1996 was $36,699,000.

11. SHARE CAPITAL

a. *Details of share capital*

Authorized Share Capital:

Unlimited number of Preference Shares
One Special Share
Unlimited number of Common Shares

Issued Share Capital:

		1997		1996
		(in thousands)		
One Special Share	$	—	$	—
70,000,000 Common Shares (1996-nil)		400,000		—
	$	400,000	$	—

During the year the Company converted $400 million of long-term debt into 70 million Common Shares and one Special Share of the Company (Note 1).

b. *Preference Shares*
The Preference Shares are of two classes, issuable in one or more series, for which the directors of the Company may fix the number of shares and determine the designations, rights, privileges, restrictions and conditions.

c. *Special Share*
The Special Share was issued to and may only be held by the Province of Manitoba. As long as the Province of Manitoba owns the Special Share, neither the Company nor any affiliate may effect one of the fundamental changes described in the Reorganization Act or issue any securities without the consent of the Lieutenant Governor in Council. The Special Share also entitles the Province of Manitoba to elect four directors of the Company.

The Special Share will be redeemed for $1 when all indebtedness to the Province of Manitoba has been repaid, which must be no later than December 31, 2000.

d. *Common Shares*
Subject to the restrictions which may be imposed by the holder of the Special Share as described on page 39, the holders of the Common Shares are entitled to one vote per Common Share on all matters to be voted on by the holders of Common Shares and are entitled to receive such dividends as may be declared by the Board of Directors of the Company. The holders of Common Shares are entitled to participate equally, on a share-for-share basis, but rank junior to Preference Shares that may be outstanding, with respect to the payment of dividends and in the distribution of assets of the Company in the event of liquidation, dissolution or winding-up.

The Reorganization Act (Note 1) provides that the total number of voting shares that may be beneficially owned by any shareholder or group of associated shareholders may not exceed 10% of the total number of issued and outstanding voting shares.

The holders of Common Shares can elect all directors of the Company with the exception of the four elected by the holder of the Special Share.

e. *Employee Share Ownership Plan*
Effective January 1, 1998, the Company implemented an employee share ownership plan under which eligible employees can purchase common shares, through regular payroll deductions by contributing between 1% and 6% of pay. For every $4 contributed by an employee, the Company contributes $1. The Company will record its contributions as a component of operating expenses. All Common Shares issued to employees under the plan will be purchased at fair market value.

f. *Stock Options*
The Company has a stock option plan under which the Board may grant common share purchase options to key employees and directors at a price not less than the weighted average of the prices at which the Common Shares traded on the five days immediately preceding the date of grant. The Company has reserved a maximum of 3.5 million Common Shares to meet rights outstanding under the stock option plan.

During 1997 the Board granted 807,500 stock options to directors and officers of the Company of which 807,500 remain outstanding at an average price of $14.69 per share. The right to exercise the option accrues to the holder at a rate of 20% per year over a period of 5 years of service and terminates 10 years after the date of grant.

12. FINANCIAL INSTRUMENTS

With the exception of long-term debt, the historical cost carrying amount of the Company's current financial assets and liabilities, which are subject to normal trade terms, approximates the fair value. The Company's long-term debt, which is disclosed in Note 10, was restructured on January 7, 1997, as described in Note 1. The Province of Manitoba Advances are not readily marketable because of the associated terms and conditions. As a consequence, it is not practicable to determine the fair value of these Advances with sufficient reliability to disclose it in these financial statements.

The Medium Term Note Payable with a cost of $80 million had a fair market value of $82,336,000 as at December 31, 1997.

During the years ended December 31, 1997 and 1996, the Company has not utilized any derivative financial instruments.

13. EXTRAORDINARY ITEM

As disclosed in Note 2(a) to the consolidated financial statements, the Company has discontinued the use of regulatory accounting provisions as a result of the introduction of price cap regulation. As a result of the discontinuation, the Company recorded a fourth quarter extraordinary noncash after-tax charge of $28.3 million or $0.40 per common share. The future income tax benefit of this charge, which has not been recognized in these consolidated financial statements, will be recognized as part of continuing operations when realized.

This extraordinary charge results from the elimination from the consolidated balance sheet of the effect of any regulatory asset or liability which would not have been recognized as assets or liabilities had it not been for the use of regulatory accounting provisions, and includes costs in the amount of $18.8 million for employee reduction programs committed to during 1997.

14. COMMITMENTS

a. *Lease commitments*

The Company rents buildings and construction and other equipment under operating leases. Future minimum lease commitments are as follows:

		(in thousands)
1998	$	3,747
1999		2,683
2000		2,288
2001		2,111
2002		924

b. *Option to purchase*

During 1994, the Company entered into an agreement with a third party that would allow for the third party to exercise an exclusive, one-time option to purchase not less than ten percent and not more than twenty percent of the Company's *Yellow Pages* business. The option expired unexercised on August 24, 1997.

c. *Contractual obligations*

The Company has entered into various long-term contractual commitments for services required in the normal course of operations. These commitments expire on various dates ranging between four and seven years. Future contractual commitments for these services are as follows:

		(in thousands)
1998	$	18,437
1999		20,403
2000		17,290
2001		15,048
2002		2,575

15. EARNINGS PER SHARE

Earnings per share for the year ended December 31, 1996, have been calculated as though the application of the Company's sinking fund assets against the long-term debt and the conversion of $400 million of long-term debt into 70 million Common Shares and one Special Share (Note 1) had occurred at January 1, 1996. For the purpose of this calculation, net income has been increased by $43.3 million which represents the elimination of the 1996 interest expense and administration fee on the $400 million of converted long-term debt, net of the interest income which would have otherwise been earned on the sinking fund.

16. COMPARATIVE FIGURES

The prior period figures have been reclassified where necessary to conform to 1997 presentation.

DIRECTORS AND OFFICERS

BOARD OF DIRECTORS

(as at December 31, 1997)

THOMAS E. STEFANSON
Chairman
Manitoba Telecom Services Inc. and MTS NetCom Inc.

ROBERT M. CHIPMAN
Chairman
The Megill-Stephenson Company Limited

JOCELYNE M. CÔTÉ-O'HARA
Principal
C2O & Company

N. ASHLEIGH EVERETT
Chairman
Royal Canadian Properties Limited
President
Royal Canadian Securities Limited

JOHN F. FRASER, O.C.
Chairman
Air Canada

WILLIAM C. FRASER
President & Chief Executive Officer
Manitoba Telecom Services Inc. and MTS NetCom Inc.

RAYMOND L. McFEETORS
President & Chief Executive Officer
The Great-West Life Assurance Company and London Life Insurance Company

C. ARNOLD L. MORBERG
President & Chief Executive Officer
Calm Air International Ltd.

DONALD H. PENNY, F.C.A.
Managing Partner
Meyers Norris Penny & Co.

ARTHUR R. SAWCHUK
President & Chief Executive Officer
Avenor Inc.

D. SAMUEL SCHELLENBERG
General Manager
Pembina Valley Water Cooperative Inc.

OFFICERS

(as at December 31, 1997)

THOMAS E. STEFANSON
Chairman
Manitoba Telecom Services Inc. and MTS NetCom Inc.

WILLIAM C. FRASER
President & Chief Executive Officer
Manitoba Telecom Services Inc. and MTS NetCom Inc.

CHERYL BARKER
Vice President Finance & Chief Financial Officer
Manitoba Telecom Services Inc.
Vice President Finance
MTS NetCom Inc.

WILLIAM F. BAINES
President & Chief Operating Officer
MTS NetCom Inc.

JAMES M. FITZGERALD
President & Chief Operating Officer
MTS Mobility Inc.

BRUCE G. MacCORMACK
President & Chief Operating Officer
MTS Advanced Inc.

ROGER H. BALLANCE
Executive Vice President Strategic Planning
Manitoba Telecom Services Inc.

WAYNE S. DEMKEY
Corporate Controller
Manitoba Telecom Services Inc.

PATRICIA A. SOLMAN
Treasurer
Manitoba Telecom Services Inc.

HEATHER J. NAULT[1]
Vice President Corporate & Regulatory Affairs & Acting Corporate Secretary
Manitoba Telecom Services Inc.

[1]Retired effective February 1998

BOARD OF DIRECTORS

Front row, left to right: **THOMAS E. STEFANSON, RAYMOND L. McFEETORS, JOCELYNE M. CÔTÉ-O'HARA, JOHN F. FRASER, O.C.** *Back row, left to right:* **C. ARNOLD L. MORBERG, D. SAMUEL SCHELLENBERG, N. ASHLEIGH EVERETT, ARTHUR R. SAWCHUK, ROBERT M. CHIPMAN, WILLIAM C. FRASER, DONALD H. PENNY, F.C.A.**

FIVE YEARS IN REVIEW

(Not subject to auditors' report)

	1997	1996	1995	1994	1993
STATEMENT OF OPERATIONS					
(in thousands)					
Total operating revenues	$ 620,153	$ 589,325	$ 540,127	$ 530,787	$ 538,616
Total operating expenses	505,171	484,582	449,339	446,945	445,822
Other income	9,056	12,578	14,668	20,477	17,662
Debt charges	36,706	84,921	90,339	89,954	90,367
Income before extraordinary item	84,664	32,400	15,117	14,365	20,089
Extraordinary item	28,250	—	—	—	—
Cash flow from operations	253,043	186,928	153,404	168,317	160,474
EBITDA	305,570	296,044	259,207	256,880	255,121
RACE *	12.7%	13.0%	6.7%	6.8%	10.4%
BALANCE SHEET					
(in thousands)					
Property, plant, and equipment	$2,177,530	$2,186,169	$2,138,808	$2,104,609	$2,058,139
Accumulated depreciation	1,141,254	1,121,896	1,036,797	1,014,163	973,241
Investments and sinking funds	11,711	395,808	369,164	350,252	342,279
Long-term debt	305,306	673,685	683,532	706,573	831,325
Shareholders' equity	662,814	265,140	232,740	217,623	203,258
TELEPHONE STATISTICS					
Network access lines	679,303	666,910	658,017	645,357	630,349
Cellular customers	104,826	86,256	62,893	41,021	28,270
Internet customers	20,500	10,100	2,200	—	—
Plant investment per NAL	$ 3,206	$ 3,266	$ 3,250	$ 3,261	$ 3,265
Long distance minutes *(in thousands)*	755,046	739,135	727,919	N/A	N/A
OTHER STATISTICS					
Salaries and wages *(in thousands)*	$ 176,837	$ 174,468	$ 189,024	$ 190,298	$ 194,293
Number of employees	3,614	3,688	3,956	4,257	4,408
Long-term debt percentage of total invested capital	36.8	75.7	78.4	79.3	80.9
Debt charge coverage ratio	3.4	1.4	1.2	1.2	1.2
Net construction expenditures *(in thousands)*	$ 134,630	$ 135,199	$ 155,931	$ 151,198	$ 170,010

* Return on average common equity, before extraordinary item.

INVESTOR INFORMATION

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SHARE TRANSFER AGENT AND REGISTRAR

Montreal Trust Company of Canada
200 Portage Avenue
Mezzanine Level
Winnipeg Manitoba R3C 3X2
Telephone (888) 267-6555 or (204) 985-3048

MARKET TRADING INFORMATION

The Company's Common Shares are listed on the Winnipeg, Toronto, and Montreal stock exchanges. Their symbol is MBT.

ANNUAL MEETING

An Annual Meeting of the shareholders of MTS will be held at the Lombard Hotel, West/Midway Ballroom, Winnipeg, Manitoba, on April 30, 1998, at 11:00 a.m. central.

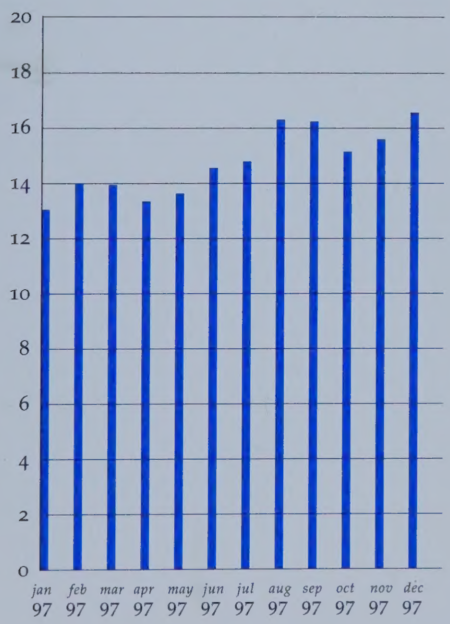
DUPLICATE ANNUAL REPORTS

If you have received duplicate copies of this annual report, please call MTS Corporate Communications at (800) 565-1936.

INVESTMENT INFORMATION ONLINE

MTS publishes relevant investor information, including quarterly reports, dividend and special notices, on its web site at http://www.mts.mb.ca.

MTS COMMON SHARES FROM INCEPTION TO 12/31/97



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